(4)

No. 96 - 1923

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

EDWARD S. COHEN,

Petitioner,

v.

HILDA DE LA CRUZ; NELFO C. JIMENEZ; MARIA MORALES; GLORIA SANDOVAL; HECTOR SANTIAGO; SANTIA SANTOS; ELBA SARAVIA; ELVIA SIGUENZIA; ENILDA TIRADO,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR PETITIONER

HOWARD J. BASHMAN
JOHN FRANCIS GOUGH
MONTGOMERY, MCCRACKEN WALKER & RHOADS, LLP
123 South Broad Street
Philadelphia, PA 19109
(215) 772-1500

DONALD B. AYER
(Counsel of Record)
JAMES E. ANKLAM
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3939

Counsel for Petitioner

4088

QUESTION PRESENTED FOR REVIEW

Whether 11 U. S. C. § 523(a)(2)(A), which excepts from discharge in bankruptcy "any debt . . . for money . . . to the extent obtained by . . . fraud," prohibits an individual debtor from discharging the non-compensatory punitive or treble damages portion of a fraud judgment?

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BRIEF FOR PETITIONER

The plain language of 11 U. S. C. § 523(a)(2)(A) makes it unmistakably clear that Congress intended to except from discharge in bankruptcy only the compensatory portion of an award on account of fraud. Because the courts below misconstrued § 523(a)(2)(A)'s language to except from discharge not only the compensatory portion of a fraud judgment but also the admittedly non-compensatory punitive or treble damages portion of such an award, petitioner Edward S. Cohen respectfully requests that the judgment of the United States Court of Appeals for the Third Circuit be reversed.

CITATION OF THE OPINIONS AND JUDGMENTS DELIVERED IN THE COURTS BELOW

The Third Circuit's opinion in this matter is reported, *Cohen v. De La Cruz*, 106 F. 3d 52 (1997), and is reprinted in the appendix to the petition, Pet. App. 2a-18a. The Third Circuit's order denying rehearing and a suggestion for rehearing *en banc* is unreported but is reprinted in the appendix to the petition, Pet. App. 1a. The opinion of the United States District Court for the District of New Jersey is reported at 191 B. R. 599 (1996) and is reprinted in the appendix to the petition, Pet. App. 19a-35a. Two relevant decisions of the United States Bankruptcy Court for the District of New Jersey are reported, 185 B. R. 171 (1994) and 185 B. R. 180 (1995), and are reprinted in the appendix to the petition, Pet. App. 55a-71a and 36a-54a.

GROUND ON WHICH THIS COURT'S JURISDICTION IS INVOKED

This Court has jurisdiction to review the judgment of the United States Court of Appeals for the Third Circuit pursuant to 28 U. S. C. § 1254(1) (1994).

The Third Circuit issued its judgment on February 6, 1997. Thereafter, Cohen filed a timely petition for rehearing containing a suggestion for rehearing *en banc*. The Third Circuit denied the petition for rehearing and refused the suggestion for rehearing *en banc* on March 5, 1997.

On June 3, 1997, Cohen filed a petition for writ of certiorari. This Court granted certiorari on September 29, 1997.

STATUTE INVOLVED

In relevant part,[1] 11 U.S.C. § 523 provides:

Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

* * *

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing—

(i) that is materially false;
(ii) respecting the debtor's or an insider's financial condition;
(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
(iv) that the debtor caused to be made or published with intent to deceive; or

(C) for purposes of subparagraph (A) of this paragraph, consumer debts owed to a single creditor and aggregating more than $1,000 for "luxury goods or services" incurred by an individual debtor on or within 60 days before the order for relief under this

[1] 11 U.S.C. § 523 in its entirety appears in Pet. App. at 72a-78a.

title, or cash advances aggregating more than $1,000 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 60 days before the order for relief under this title, are presumed to be nondischargeable; "luxury goods or services" do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor; an extension of consumer credit under an open end credit plan is to be defined for purposes of this subparagraph as it is defined in the Consumer Credit Protection Act;

* * *

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

* * *

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty—

(A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or

(B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition;

* * *

(9) for death or personal injury caused by the debtor's operation of a motor vehicle if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance;

* * *

(c) (1) Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), (6), or (15) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), (6), or (15), as the case may be, of subsection (a) of this section.

(2) Paragraph (1) shall not apply in the case of a Federal depository institutions regulatory agency seeking, in its capacity as conservator, receiver, or liquidating agent for an insured depository institution, to recover a debt described in subsection (a)(2), (a)(4), (a)(6), or (a)(11) owed to such institution by an institution-affiliated party unless the receiver, conservator, or liquidating agent was appointed in time to reasonably comply, or for a Federal depository institutions regulatory agency acting in its corporate capacity as a successor to such receiver, conservator, or liquidating agent to reasonably comply, with subsection (a)(3)(B) as a creditor of such institution-affiliated party with respect to such debt.

(d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

* * * *

STATEMENT OF THE CASE

Petitioner Edward S. Cohen and his father owned and managed several New Jersey apartment buildings during the mid to late 1980s. Pet. App. 55a. Two of the respondents, Santia Santos and Enilda Tirado, were tenants in one such building in Hoboken

subsequently purchased by petitioner and his father. The remaining respondents thereafter became tenants in that building. Pet. App. 57a-60a.

Petitioner, who was unfamiliar with the details of Hoboken's rent control ordinance, continued to charge respondents Santos and Tirado the rents they had paid to the former landlord. Pet. App. 59a-60a. Unbeknownst to petitioner, Santos' rent exceeded the maximum lawful rent permitted by the Hoboken rent control ordinance.[2]

Petitioner also erroneously thought that Hoboken's rent control ordinance did not govern the rents that could be charged to new tenants. Pet. App. 60a. Because petitioner believed he could charge market-based rents to new tenants, he charged the remaining respondents rent in excess of what the rent control ordinance allowed. Pet. App. 60a. These rental overcharges ranged in amount from $728.00 to $5,975.00. Pet. App. 38a-39a (stipulation of actual rent overcharges).

The Hoboken Rent Leveling and Stabilization Board advised Cohen in 1989 that these rents exceeded what the applicable rent control ordinance permitted. Pet. App. 57a. On November 21, 1990, Cohen filed a petition for relief under Chapter 7 of the Bankruptcy Code. Pet. App. 56a.

On February 14, 1991, respondents commenced an adversary proceeding in petitioner's bankruptcy case to prevent petitioner from discharging in bankruptcy the rent overcharges. Pet. App. 62a. The tenants alleged that these overcharges were not dischargeable as debts for money obtained by actual fraud. Pet. App. 62a. Respondents also brought a claim under New Jersey's Consumer Fraud Act, N. J. Stat. Ann. §§ 56:8-1 to 8-20, which,

[2] The parties have stipulated that Cohen did not charge Tirado rent in excess of the rent control ordinance. Pet. App. 38a-39a (stipulation of actual rent overcharges noting that Ms. Tirado sustained $0 in overcharges).

if successful, would enable them to receive treble damages, costs and attorneys' fees. Pet. App. 54a.

On October 24, 1994, the bankruptcy court ruled that Cohen was recklessly indifferent to the existence and applicability of Hoboken's rent control ordinance and thus was liable for having committed "actual fraud" as that term is used in 11 U. S. C. § 523(a)(2)(A) (1994). Pet. App. 69a.

On June 19, 1995, the bankruptcy court determined the damages to be awarded respondents. Pet. App. 36a-37a. The parties stipulated from the outset the precise amount of overcharges that Cohen obtained from each respondent, amounts totalling $31,382.50. Pet. App. 38a-39a. The bankruptcy court ruled that respondents had produced sufficient evidence to establish petitioner's liability under New Jersey's Consumer Fraud Act. Pet. App. 50a. Based upon its earlier finding that Cohen's conduct in violation of Hoboken's rent control ordinance was reckless, the court concluded that Cohen had committed an "unconscionable commercial practice" triggering his liability under the Consumer Fraud Act. Pet. App. 50a. Pursuant to that Act, N.J. Stat. Ann. § 56:8-19 (1989), the court awarded three-fold damages of $94,147.50. Pet. App. 51a-54a.

The bankruptcy court considered whether punitive damages for fraud, such as the Consumer Fraud Act's treble damages provision, were excepted from discharge by § 523(a)(2)(A). Pet. App. 51a. After noting the conflict between the United States Courts of Appeals for the Ninth and Eleventh Circuits on that issue, the bankruptcy court held that such damages should be deemed dischargeable. Pet. App. 53a. The damages "that will be deemed nondischargeable under section 523(a)(2)(A) shall include the treble damages." Pet. App. 53a.

Cohen appealed from the bankruptcy court's rulings to the United States District Court for the District of New Jersey. The district court affirmed the bankruptcy court's rulings in all respects. Pet. App. 19a. In particular, the district court ruled that "statutorily imposed treble damages . . . are not dischargeable under § 523(a)(2)(A)," reasoning that "a debtor liable

for punitive damages because of . . . fraud should not be permitted to have that debt discharged." Pet. App. 33a-34a.

Cohen, proceeding without counsel, appealed from the district court's ruling to the United States Court of Appeals for the Third Circuit. A panel of that court, in an opinion written by Senior District Judge Hillman, affirmed without discussion the district court's order affirming the bankruptcy judge's findings of fraud under both the Bankruptcy Code and the New Jersey Consumer Fraud Act. Pet. App. 5a. Recognizing that "the question of whether punitive damages are dischargeable under 11 U. S. C. § 523(a)(2)(A) is the subject of a split in the circuits," Pet. App. 6a, the panel addressed that issue in detail. The panel commenced its analysis by examining the plain language of the statute and its legislative history. Pet. App. 8a-12a. Subsequently, the panel looked to "policy considerations" to support its conclusion that "punitive damages are nondischargeable under 11 U. S. C. § 523(a)(2)(A)." Pet. App. 14a. In particular, the court considered the difficulty victims of fraud would face in obtaining legal representation to pursue actions since the amount of actual damages "is often not large." Pet. App. 13a.

In dissent, Judge Greenberg argued that these punitive damage awards should be discharged under § 523(a)(2)(A). Pet. App. 14a-15a (Greenberg, J., dissenting). Judge Greenberg emphasized that "[p]unitive damages are simply a penalty and are something a debtor pays rather than obtains." Pet. App. 15a (Greenberg, J., dissenting). Furthermore, Judge Greenberg explained that the majority's reading of the statutory language renders a portion of the bankruptcy statute superfluous. Pet. App. 15a (Greenberg, J., dissenting).

Cohen filed a *pro se* petition for rehearing and a suggestion for rehearing *en banc*. The Third Circuit, which at the time had twelve active judges, denied Cohen's suggestion for rehearing *en banc* because only six of its judges voted to grant the suggestion. Pet. App. 1a. Circuit Judges Becker, Stapleton, Greenberg, Scirica, Alito and Roth voted in favor of granting rehearing *en banc*. Pet. App. 1a.

Thereafter, Cohen filed a petition for writ of certiorari in this Court. On September 29, 1997, this Court granted certiorari.

SUMMARY OF THE ARGUMENT

The plain meaning of 11 U.S.C. § 523(a)(2) controls the outcome of this case. That language excepts from the general discharge rule of § 727 only "[d]ebts . . . for money . . . to the extent obtained by" fraud. Exemplary or punitive amounts awarded as punishment for fraudulent conduct in addition to the amounts actually "obtained by" fraud clearly fall outside of this exception. The decision of the court below to the contrary could only be reached by ignoring the explicit limiting language of the section, contrary to the admonitions of this Court that statutes should be read where possible so as to give meaning to all of their terms. Interpretation of § 523(a)(2) in accordance with its plain meaning is also required by the longstanding principle, derived from the central policy of the bankruptcy laws to allow individual debtors a fresh start, that exceptions to discharge are to be construed narrowly.

The construction of § 523(a)(2) to except only debts owed for money "obtained by" fraud is also reinforced by comparison with statutory language that existed prior to the 1984 enactment of the present provision. That language excepted from discharge debts or liabilities "for obtaining" money or other property by fraud. While susceptible to interpretation as in fact excepting both compensatory and punitive damages — since "debts for obtaining money by fraud" arguably reaches all of any judgment based on fraudulent conduct — that language can also be read more narrowly in a manner consistent with the present provision. And the case law interpreting the prior provision fails to definitively resolve the ambiguity, since most of the cases finding punitive damages nondischargeable rest also on conduct characterized as willful and malicious, which has long been a separate exception to discharge consistently construed to encompass punitive damages. Congress's change in 1984 from the previous, ambiguous provision to the present unambiguous language, made clear

beyond doubt that punitive damages are not to be encompassed within the § 523(a)(2) provision.

No basis for doubting the plain meaning of the statute arises from anything that this Court has said relating to the purpose of the bankruptcy system to assist the "honest but unfortunate debtor." Those statements in no way suggest that persons who have committed fraud against their creditors are to be denied access to the bankruptcy system, or that the explicit exceptions to discharge set forth in § 523(a) are somehow to be applied other than in accordance with their terms.

Further, the limited construction of § 523(a)(2) in accordance with its language creates a logical relationship between it and other discharge exceptions. In particular, (a)(2), as the general discharge exception reaching all forms of fraudulent conduct encompassed in § 523(a), overlaps with two other exception provisions, §§ 523(a)(4) and (a)(6), which, respectively, reach fraud by a fiduciary, and willful and malicious conduct. These other two provisions address defined conduct that Congress has singled out as particularly egregious. In doing so, it used language different from that in (a)(2) — referencing simply "debts for" the conduct addressed — which has been fairly read to encompass punitive as well as compensatory awards. If § 523(a)(2) is read in accordance with its terms to except compensatory but not punitive amounts, both of these provisions retain significance within the Code and the difference in language used is respected. If (a)(2) is read in the broad manner of the court below, the portion of (a)(4) addressing fraud by a fiduciary becomes superfluous and the different language used by Congress is ignored.

Construing (a)(2) in accordance with its terms also harmonizes it with §§ 523(a)(7) and (a)(9), which render nondischargeable debts, including punitive awards that are, respectively, penalties paid to the government, and awards for death or personal injury resulting from drunk driving. Unlike (a)(2), both of these provisions utilize language consistent with the conclusion that punitive awards in those circumstances are to be excepted from

discharge, and both appear to reflect legislative judgments favoring personal accountability — and thus nondischargeability — for the specific types of debts addressed.

Finally, a reading of § 523(a)(2) to except punitive damages results in a substantial intrusion upon the fresh start policy that is at the heart of the bankruptcy law as it relates to individuals. As the general nondischarge provision covering debts for moneys obtained by fraud, (a)(2) reaches misrepresentations and concealment, whether knowingly false or, as in this case, based on recklessness. The effect of reading (a)(2) to except punitive, as well as compensatory awards, arising from this conduct broadens substantially the nondischargeability of punitive amounts in connection with any type of fraudulent conduct. This result upsets the balance that has been struck by Congress and impairs the effectiveness of the fresh start policy in a manner incompatible with the legislative intent.

ARGUMENT

SECTION 523(a)(2) ALTERS SECTION 727'S RULE OF DISCHARGEABILTY ONLY FOR AMOUNTS OF MONEY ACTUALLY "OBTAINED BY" FRAUD, AND NOT FOR ANY PENALTY AWARDED IN CONNECTION WITH THE UNDERLYING FRAUDULENT CONDUCT

This is a case in which the correct result flows from faithful application of the "fundamental canon that statutory interpretation begins with the language of the statute itself." *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 557-58 (1990); *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 685 (1985). The language of the statute leads unambiguously to the conclusion that the non-dischargeability provision of 11 U.S.C. § 523(a)(2) pertains only to money (or other things of value) actually obtained by means of the conduct referenced in the statute, and that it has no impact on the dischargeability under Chapter 7 of any penalties or punitive damages that may be assessed on the basis of the particular conduct in issue. When that conclusion is viewed in the context of the Bankruptcy Code as a

whole and the purposes and policies behind it, *see United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 242 (1989), it is entirely consistent with those intentions. Accordingly, the decision of the court below, holding non-dischargeable the non-compensatory, penalty provision of the treble damages awarded under the New Jersey Consumer Fraud Act, N.J. Stat. Ann. §§ 56:8-2, 8-19, must be reversed.

A. The Plain Language Of Section 523(a)(2) Compels This Result

1. Section 727 of the Bankruptcy Code provides the general rule of discharge for individual debtors, such as the petitioner in this case, who undergo a Chapter 7 liquidation. Where the required conditions are met, *see* 11 U.S.C. § 727(a)(1)-(10) (1994), that provision directs that "the court shall grant the debtor a discharge." *Id.* § 727(a).[3] Section 727(b) further states that

> Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter . . . .

11 U.S.C. § 727(b) (1994). This discharge provision has long been at the heart of the Bankruptcy Code and its predecessor statutes, offering, as it does, relief to individuals "from the burden of hopeless insolvency." *Forsyth v. Vehmeyer*, 177 U.S. 177, 181 (1900). It remains the "central purpose" of bankruptcy to provide a procedure by which qualifying debtors can secure a "new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Grogan v. Garner*, 498 U.S. 279, 286 (1991) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)).

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[3] Generally, the effect of a discharge is to void judgments with respect to debts discharged, 11 U.S.C. § 524(a)(1) (1994), and to enjoin actions to collect such debts. 11 U.S.C. § 524(a)(2).

At issue in this case is the meaning of a single provision of § 523, on which basis the Third Circuit held that the mandatory discharge provision of § 727(a) was inapplicable to a non-compensatory, punitive award. The relevant language of § 523(a)(2) states:

Section 523. Exceptions to discharge.

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

* * *

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; . . .

11 U.S.C. § 523(a)(2)(A).[4]

The evident intention of this language is to deny discharge for the value of any "money," "property," "services" or "credit" that the creditor has lost as a result of the fraudulent conduct defined in the section. As a result, a creditor is given a chance

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[4] While § 523(a) applies by its terms to create exceptions to discharge not only under Chapter 7, but under Chapter 11, Chapter 12, and Chapter 13 as well, the provisions of those chapters define which of the exceptions are applicable in each instance. In general, the § 523(a) exceptions apply in full to Chapter 11 and Chapter 12 debtors. 11 U.S.C. §§ 1141(d) (1994), 1228(a)(2) & (c)(2) (1994). A Chapter 13 debtor who made all the payments under his plan escapes the full effect of § 523(a) and only debts described in § 523(a)(5), (8), (9) and restitution debts are not discharged. *Id.* § 1328(a)(2) & (3) (1994). A Chapter 13 debtor who seeks a discharge without making all payments of the plan remains subject to all the § 523(a) exceptions. *Id.* § 1328(c)(2).

to recover — after the bankruptcy is final, if necessary — for such sums procured by fraud.[5] By limiting this particular discharge exception to debts for money and other property "to the extent obtained by false pretenses, a false representation, or actual fraud," the section has no effect upon the dischargeability of debts for money not so "obtained." Exemplary relief of any kind, be it punitive damages under the common law, multiple damages under a specific statutory provision, attorneys' fees, or other monetary payments, exceeds that statutory mandate because it does not involve value that was "obtained" in any sense.

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[5] Fraud as the term is used in the Bankruptcy Code extends not only to conduct involving known falsehood, but to that based on reckless disregard for the truth as well. This definition, which is a matter of federal law, is consistent with general tort law principles holding that "intentional fraud" includes reckless disregard of the truth of a representation. W. Prosser, *Law of Torts* § 107, at 701 (4th ed. 1971); 2 F. Harper, F. James, Jr. & O. Gray, *The Law of Torts* § 7.3, at 391 (1986); Restatement (Second) of Torts § 526 & cmt. e (1977). Indeed, this Court has stated that "[w]e construe the terms in § 523(a)(2)(A) to incorporate the general common law of torts, the dominant consensus of common-law jurisdictions, rather than the law of any particular State." *Field v. Mans*, 116 S.Ct. 437, 443 n. 9 (1995).

This definition of fraud for purposes of § 523(a) also has an antecedent in the decisions of this Court. In *Morimura, Arai & Co. v. Taback*, 279 U.S. 24, 33 (1929), the Court held that reckless disregard was sufficient to prevent the bankrupt's discharge for false representations under Bankruptcy Act § 14c(3). Thereafter, in applying the same standard for purposes of Bankruptcy Act § 17a(2) and for § 523(a)(2), lower courts have cited *Morimura*. *In re Houtman*, 568 F.2d 651, 656 (9th Cir. 1978) (interpreting § 17a(2)); *In re Kerbaugh*, 162 B.R. 255, 263 (Bankr. D. N.D. 1993) (interpreting § 523(a)); *In re Guy*, 101 B.R. 961, 977 (Bankr. N.D. Ind. 1988) (same); *In re Byrd*, 41 B.R. 555, 563 (Bankr. E.D. Tenn. 1984) (same). *See generally* P. Shuchman, *The Fraud Exception in Consumer Bankruptcy*, 23 Stan. L. Rev. 735, 742-43 (1971) (same elements under § 14c(3) and § 17a(2)).

"To the extent" is an expression of limitation indicating a distinction between various categories based on particular stated criteria.[6] To "obtain" is "to come into the possession or enjoyment of (something) by one's own effort, or by request; to procure or gain, as the result of purpose and effort; hence, generally, to acquire, get." X *Oxford English Dictionary* 669 (2d ed. 1989); *see also The Random House Dictionary of the English Language* 995 (unabridged ed. 1966) (defining "obtain" as "to come into possession of; get or acquire; procure, as through an effort or by request"). Under this definition, compensatory damages, such as the refund of the excess rents that petitioner obtained from respondents in this case, may constitute a "debt . . . for money . . . to the extent obtained by . . . fraud." They represent money that "c[a]me into the possession" of someone — in this instance, the debtor — "by [his] own effort, or by request," and that were "procur[ed] or gain[ed], as the result of purpose and effort."

Punitive damages or other forms of exemplary relief[7] awarded on account of fraud do not, however, involve money that has been "obtained" in any sense. As this Court has noted, "punitive damages are . . . not designed to compensate . . . victims." *O'Gilvie v. United States*, 117 S. Ct. 452, 455 (1996) (quotation omitted). Thus, because the amount reflected in the punitive damage award was never obtained by anyone or taken from anyone, but rather reflects a policy judgement to inflict a punishment upon the debtor for particular conduct, it falls outside the

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[6] *See, e.g., Spencer v. Laconia School Dist.*, 218 A.2d 437, 440 (N.H. 1966) ("to the extent" fixes the "full salary as the outside limit of recovery") (quotation omitted).

[7] Under the New Jersey statutory scheme, N.J. Stat. Ann. §§ 56:8-2, 8-19, the multiple damages relief "represents the punitive aspect." *Neveroski v. Blair*, 358 A.2d 473, 482 (N.J. Super. Ct. App. Div. 1976). *See also Cox v. Sears Roebuck & Co.*, 647 A.2d 454, 463 (N.J. 1994) (the Consumer Fraud Act "punishes the wrongdoer" "by awarding a victim treble damages").

category of debts that are excepted from discharge by § 523(a)(2)(A). *See* 4 *Collier on Bankruptcy* ¶ 523.08[4], at 523-53 (15th rev. ed. 1997) (punitive damages are dischargeable under § 523(a)(2) because they are "assessed in addition to the compensatory damages that are measured by the amount of property obtained by the fraudulent conduct or actual harm suffered by the creditor").

For these reasons, the Third Circuit's decision failed to recognize an express limitation of the exception to discharge created by § 523(a)(2). It has the effect of reading out of the statute the limiting language, "to the extent obtained." *See* Pet. App. 15a (Greenberg, J., dissenting). In doing so, it acted counter to this Court's "deep reluctance" — often expressed in the context of decisions construing the Bankruptcy Code — "to inter-pret a statutory provision so as to render superfluous other provisions in the same enactment." *Davenport*, 495 U.S. at 562; *Rake v. Wade*, 508 U.S. 464, 471-472 (1993).

2. The plain meaning that flows from the language of § 523(a)(2) is reinforced by the long-standing principle of narrow construction applicable to the exceptions to discharge. Since debts that are not discharged at the close of bankruptcy remain to be dealt with by the post-bankrupt debtor, the effect of the non-discharge provisions is to impair the debtor's ability to start over fresh, free from the burden of his obligations so that he may be given a new economic start in life. *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. 549, 554-55 (1915). Given the centrality of the fresh start policy to the purposes of the bankruptcy law as applied to individuals, *Grogan v. Garner*, 498 U.S. at 286; *Traer v. Clews*, 115 U.S. 528, 541 (1885), it follows that the nondischargeability provisions must be construed narrowly. As this Court stated in *Gleason v. Thaw*, 236 U.S. 558, 562 (1915), in construing a predecessor to the provision at issue in this case:

> In view of the well-known purposes of the Bankrupt Law, exceptions to the operation of a discharge thereunder should be confined to those plainly expressed.

In so stating, the Court was following a line of earlier decisions in which this Court had generally read the exceptions to discharge narrowly – and especially those pertaining to fraud – on the ground that such an approach is "consonant with equity" and with "the liberal spirit which pervades the entire bankrupt system." *See Neal v. Clark*, 95 U.S. 704, 709 (1877); *Forsyth v. Vehmeyer*, 177 U.S. at 181. This principle of narrow construction of exceptions to discharge remains an important rule of construction under the Bankruptcy Code.[8]

3. The interpretation indicated by the plain words of the section, narrowly construed, is further reinforced by a comparison of the present language of § 523(a)(2), as adopted in 1984, with the predecessor language in the 1978 Bankruptcy Code[9] and in

[8] *In re Menna*, 16 F.3d 7, 9-10 (1st Cir. 1994); *In re Miller*, 39 F.3d 301, 304 (11th Cir. 1994); *In re Boyle*, 819 F.2d 583, 588 (5th Cir. 1987); *In re Black*, 787 F.2d 503, 505 (10th Cir. 1986); 4 *Collier on Bankruptcy* ¶ 523.05.

[9] Section 523(a)(2)(A) of the Bankruptcy Code as adopted in 1978, provided:

> (a) A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> * * *
>
> (2) for obtaining money, property, services, or an extension, renewal, or refinance [*sic*] of credit, by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition. . . .

Pub. L. No. 95-598, 92 Stat. 2549, 2590 (codified at 11 U.S.C. § 523(a)(2) (1978)). *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 454, 98 Stat. 333, 375.

the statute as it existed just prior to the adoption of the Code.[10] Both of these prior statutes defined the (a)(2) discharge exception as extending to debts or liabilities "for obtaining money" or other property by means of various fraudulent acts. That prior language was arguably ambiguous, since the liability "for obtaining" money by fraud might be construed to reach only the money actually obtained by fraud, or to reach the full amount of any judgment entered against the debtor on account of the fraud — including any punitive sum. The cases finding punitive damages for fraud nondischargeable during the period that this language was in effect[11] did not resolve this ambiguity with any

[10] Immediately prior to the adoption of the Bankruptcy Code, the relevant provisions of § 17a read as follows:

> (a) Debts not affected by a discharge. A discharge in bankruptcy shall release a bankrupt from all his provable debts, whether allowable in full or in part, except such as . . . (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the property of another; . . . . (4) were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity; . . . . (8) are liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) of this subdivision.

11 U.S.C. § 35(a) (1977).

[11] The issue of discharge for exemplary damages appears to have arisen only infrequently under the 1898 Act. Historically, punitive or exemplary damages were rarely "assessed and likely to be small in amount." D. Ellis, Jr., *Fairness & Efficiency in the Law of Punitive Damages*, 56 S. Cal. L. Rev. 1, 2 (1982); R. Blatt, *Punitive Damages* § 1.2.B (1991). In recent years, "awards of punitive damages [have been] skyrocketing." *Browning-Ferris Indus. v. Kelco Disposal, Inc.*,

clarity, since they often involved debts which arose from conduct that was acknowledged to be both fraudulent and "willful and malicious." Bankruptcy Act § 17a(2) (pre-1970) (included willful and malicious injuries); § 17a(8) (after 1970 amendments) (new subsection for willful and malicious injuries). *E.g., Coen v. Zick*, 458 F.2d 326, 329-30 (9th Cir. 1972) (finding punitive damages for fraud non-dischargeable where they were also liabilities for "willful and malicious injuries to the person or property of another") (interpreting the pre-1970 version of § 17a(2)); *National Homes Corp. v. Lester Indus., Inc.*, 336 F. Supp. 644 (W.D. Va. 1972) (same); *In re Carpenter*, 17 B.R. 563, 564 (Bankr. E.D. Tenn. 1982) (noting willful and malicious actions and finding non-discharge under the post-1970 version of § 17a(2)); *but cf. In re Houtman*, 568 F.2d 651 (finding non-discharge of entire debt, including punitives, relying on § 17a(2), without reference to "willful and malicious injury"). It is thus wrong to suggest, as did the Third Circuit, Pet. App. 11a-12a, that the predecessor to the current statute, on its face and as construed, clearly excepted punitive damages from discharge. At most the statute was ambiguous on that point.

Even more clearly, the Third Circuit erred in relying on this Court's decisions in *Kelly v. Robinson*, 479 U.S. 36, 47 (1986) and *Davenport*, 495 U.S. at 563-64, for the proposition that "if Congress intends for legislation to change the interpretation of a judicially created concept, it makes the intent specific." Pet. App. 11a. While it is by no means clear that the 1978 Code

492 U.S. 257, 282 (1989) (O'Connor, J., concurring in part and dissenting in part). Moroever, some states have adopted statutes modifying the traditional standards for fraud, by lowering the burden of proof on the complainant and by making exemplary damages mandatory. *See generally* 2 F. Harper, *The Law of Torts* § 7.1, at 378-80 (describing trend). This interplay between the recent growth in amount and frequency of punitive damages awards, the lower standards for statutory fraud claims in some states, and § 523(a)(2) gives greater prominence today to the issue of discharge for punitive damages for fraud.

provision in fact intended a different meaning than the language adopted in 1984, the latter language certainly makes its "intent specific." By explicitly altering the relevant language defining the debts made non-dischargeable from "liabilities for obtaining money" by fraud to "debts . . . for money . . . to the extent obtained by" fraud, Congress made clear beyond peradventure that exemplary damages are not encompassed within the provision. Where that is true, this Court has not hesitated to follow the specific language of the statute, even if it results in a departure from prior bankruptcy practice. *Davenport*, 495 U.S. at 563.

4. Nor is the clear import of § 523(a)(2)(A)'s language, singling out "money . . . to the extent obtained by" fraud for nondischarge, called into doubt by some notion that the benefits of the bankruptcy system must not be made available to those who commit fraudulent acts. This Court has stated in various ways that "the opportunity for a completely unencumbered new beginning" is limited to the "honest but unfortunate debtor." *E.g., Grogan*, 498 U.S. at 286-87 (quotation omitted). It is clear on its face, however, that this general proposition falls far short of barring those committing any type of fraud from access to the bankruptcy process, or from the discharge that is its principal benefit. On the contrary, § 727 is explicit in defining the forms of conduct that will bar access to a discharge, and they are limited primarily to acts of fraud or concealment directed against the bankruptcy system itself. 11 U.S.C. § 727(a)(1-10). The nondischarge provisions of § 523(a), including those addressing fraud, far from defining any general right of access to the bankruptcy process, address specifically the way in which particular kinds of debts are to be treated. The "honest but unfortunate debtor" rubric thus offers no escape from the obligation to construe the meaning of (a)(2) - and to do so in accordance with its terms.

Similarly, the court below is on no firmer ground in its invocation of dicta from *Grogan*, 498 U.S. at 286-87, concerning the extent of protection to be accorded to "perpetrators of fraud" . . . "over the interest in protecting victims of fraud." Pet. App. 13a.

As to the relevance of the referenced language, the decision whether to allow discharge of the non-compensatory portion of any award has nothing to do with protecting a creditor against the consequences of his having been victimized, since it does not involve any amount that the creditor has lost. Rather, the issue before the Court addresses whether amounts constituting a windfall to the creditor should be preserved against discharge for reasons of legislative policy. *See* Section C, *infra*.

Further, on the relevance of the *Grogan* dicta, the Court there explicitly stated that it was not deciding the question of whether § 523(a)(2)(A) renders punitive damages non-dischargeable. 498 U.S. at 282 n.2. Accordingly, it is disingenuous at best for the court below to rely on *Grogan* as somehow lending support to the lower court's holding on precisely that point. Indeed, to the extent the *Grogan* Court made any substantive comment relevant to this issue, it supported the contrary result by stating that "[a]rguably, fraud judgments in cases in which the defendant did not obtain money, property, or services from the plaintiffs and those judgments that include punitive damages awards are more appropriately governed by § 523(a)(6) . . . (excepting from discharge debts 'for willful and malicious injury . . .')," rather than under the provision at issue in this case. *Id.*

B. Recognizing That Section 523(a)(2) Is A General Fraud Discharge Exception Reaching Only Amounts "Obtained By" Fraud Creates A Logical Relationship Between It And Other Exceptions To Discharge Under Section 523, Some Of Which Render Punitive Damages Non-Dischargeable

This reading of the Bankruptcy Code is also wholly compatible with the other discharge exceptions found in § 523(a) and, in fact, is necessary in order to give meaning to certain of those other provisions. *See United States Nat'l. Bank of Oregon v. Independent Ins. Agents of Am. Inc.*, 508 U.S. 439, 455 (1993) (interpretation of particular statutory provisions can be aided by consultation of related provisions). Along with § 523(a)(2), two additional provisions of § 523(a) address categories of debts

which include amounts owed to victims of certain kinds of fraud. 11 U.S.C. §§ 523(a)(4), (a)(6). Further, two other discharge exceptions within § 523(a) address debts relating to other forms of egregious conduct, which may include punitive awards. 11 U.S.C. §§ 523(a)(7), (a)(9). In each instance, these four separate provisions have been reasonably construed to except the punitive portion of the debt in issue from discharge. These provisions are wholly consistent with the plain meaning of § 523(a)(2), because they are specific exceptions directed by Congress at conduct that it deemed especially egregious, and as to which it used language reasonably indicating an intent to except non-compensatory or punitive amounts from discharge. Section 523(a)(2), on the other hand, is a general exception from discharge which reaches only the compensatory debts that result from fraud as broadly defined in the section. Non-discharge of punitive amounts for fraud, therefore, is only appropriate where conduct can be brought within one of the other provisions, wherein Congress has identified and targeted especially egregious conduct.

1. The exceptions to discharge, in addition to § 523(a)(2), which reach debts to victims of certain specified types of fraudulent conduct by a debtor are § 523(a)(4), excepting debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny," and § 523(a)(6), excepting debts "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. §§ 523(a)(4), (a)(6).

Section 523(a)(4), insofar as it addresses fraud, deals with a particular and egregious type of fraud in violation of fiduciary relationships created by an express or technical trust, and not to the general fiduciary relationship involving trust, confidence and good faith. *See Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934) ("the statute 'speaks of technical trusts, and not those which the law implies from the contract'") (quoting *Chapman v. Forsyth*, 43 U.S. (2 How.) 202, 208 (1844)); *see also* 4 *Collier on Bankruptcy* ¶ 523.10[1][c], at 523-71. Creditors reposit significant trust in these fiduciaries, and fraudulent conduct in this situation culminates in an aggravated harm through the destruction of this special relationship. This provision has been construed to

except from discharge both compensatory and punitive damages. *See In re Bugna*, 33 F.3d 1054, 1055 (9th Cir. 1994); *In re Wallace*, 840 F.2d 762 (10th Cir. 1988). The decision by Congress thus to treat damages arising under this provision more stringently than those arising under § 523(a)(2)(A) reflects a rational determination by Congress. *See Hanover Nat'l. Bank v. Moyses*, 186 U.S. 181, 192 (1902).

Moreover, this reading of § 523(a)(4) is also supported by the different language used there as compared with § 523(a)(2). By rendering nondischargeable "debts for fraud" by a fiduciary, (a)(4) is reasonably understood as covering punitive damages, which are part of a debt incurred as a result, through judicial order, of the fraudulent conduct. While such punitive amounts are not compensatory — and certainly are not "debt[s] for money . . . to the extent obtained by . . . fraud" as required by § 523(a)(2) — they are fairly understood as debts incurred by the debtor "for" or as a result of his fraudulent conduct. *See* Pet. App. 14-15a (Greenberg, J., dissenting).

Finally, if § 523(a)(2) were construed as it was by the court below, (a)(4) would become superfluous insofar as it purports to create an exception for fraud while acting in a fiduciary capacity, since it would be fully subsumed within the broader scope of (a)(2). This Court's jurisprudence has consistently "expressed 'a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment.'" *Freytag v. C.I.R.*, 501 U.S. 868, 877 (1991) (quoting *Davenport*, 495 U.S. at 562); *Rake v. Wade*, 508 U.S. at 471 ("We generally avoid construing one provision in a statute so as to suspend or supersede another provision."). This should be especially so of a statutory provision like § 523(a)(4), that has been repeatedly enacted many times since 1898.[12]

[12] *See* Bankruptcy Act of 1898, ch. 541, § 17a(4), 30 Stat. 544, 550 (codified as amended at 11 U.S.C. § 35(a)(4) (1976)) (repealed 1978); Chandler Act, ch. 575, § 17a(4), 52 Stat. 840, 851 (1938); Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2591 (1978)

Similarly, § 523(a)(6) pertains only to debts for "willful and malicious injur[ies]," 11 U.S.C. § 523(a)(6), and has been read to make punitive damages nondischargeable. *In re Britton*, 950 F.2d 602, 606-07 (9th Cir. 1991). Early cases construing this provision (then in § 17a(2)) had excepted from discharge debts that arose from conduct less egregious than willful or malicious injuries. *See Tinker v. Colwell*, 193 U.S. 473 (1904). In enacting the Bankruptcy Reform Act of 1978, however, Congress reaffirmed that only aggravated injuries shall be excepted from discharge under this provision. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 365 (1977) *reprinted in* 1978 U.S.C.C.A.N. 5963, 6320; S. Rep. No. 989, 95th Cong., 2d Sess. 79 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5865 (stating that "to the extent that *Tinker v. Colwell*, 193 U.S. 473 (1904), held that a looser standard is intended, and to the extent that other cases have relied on *Tinker* to apply a 'reckless disregard' standard, they are overruled").

Accordingly, § 523(a)(6) reaches a broad range of conduct, including fraud, but only where it reaches this egregious level of actual malice. The fact that it is capable of rendering non-dischargeable certain punitive awards for malicious, fraudulent conduct does not in any way suggest that (a)(2) should be read to except exemplary damages in all cases of fraud, whether malicious or not. Indeed, this Court has already surmised that the opposite conclusion may follow. *Grogan*, 498 U.S. at 282 n.2.

Once again, the language used in (a)(6), in referring simply to "debts for willful and malicious injury," contrasts sharply with that in (a)(2). The (a)(6) language is easily read, as it has been, to encompass not only compensatory amounts, but any penalties assessed "for" the willful and malicious injury inflicted.

2. Similarly, the plain meaning of the words of § 523(a)(2) is also the interpretation that co-exists most easily with two other

(adopting § 523(a)(4)).

discharge exceptions which extend to punitive, non-compensatory amounts. Section 523(a)(7) excepts from discharge debts "to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual loss . . . ." 11 U.S.C. § 523(a)(7). Obviously, it is the express intention of this section to render nondischargeable a particular category of obligations specifically delimited in certain ways.[13] One limitation of the exception is that it must be "for the benefit of a governmental unit," and this Court has indicated in *dicta* its view that that limitation was probably "intended to prevent application of that subsection to wholly private penalties such as punitive damages." *Kelly*, 479 U.S. at 51 n. 13. The Court's recognition of this limitation effected by the language of § 523(a)(7) is especially relevant with regard to the construction of (a)(2), since both sections use the words "to the extent" in defining the limits of the discharge exceptions being created. Just as this Court has recognized that the words "to the extent" as used in (a)(7) define the boundary of the exception being created, so should it, in the context of (a)(2), recognize that the exception created reaches only debts "for money" or other things of value "to the extent" those things are "obtained by" fraud. *See Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 570 (1995) ("'identical words used in different parts of the same act are intended to have the same meaning'") (quoting *Department of Revenue of Oregon v. ACF Indus., Inc.*, 510 U.S. 332, 342 (1994)).

Finally, § 523(a)(9) excepts from discharge debts "for death or personal injury caused by the debtor's operation of a motor vehicle if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance." 11 U.S.C. § 523(a)(9). This provision was obviously based upon a sense of outrage that the bankruptcy system might be used to

[13] In addition to the limiting language included in the text, the exception to discharge created by § 523(a)(7) does not extend to certain tax penalties that are precisely described therein. *See* 11 U.S.C. § 523(a)(7).

avoid full legal accountability for a specific and especially flagrant form of irresponsibility that regularly inflicts widespread injury and death on innocent victims. *See* 4 *Collier on Bankruptcy* ¶ 523.15, at 523-100. One Senator characterized the section's objective as the closure of a "scandalous loophole":

> Today there exists an unconscionable loophole in the bankruptcy statute which makes it possible for drunk drivers who have injured, killed or caused property damage to others to escape civil liability for their actions by having their judgment debt discharged in the Federal bankruptcy courts. This loophole affords opportunities for scandalous abuse of judicial processes.

129 Cong. Rec. 2947 (1983) (statement of Sen. Danforth). It is not surprising that, thus motivated, Congress might elect to render punitive as well as compensatory amounts exempt from discharge. And in using the familiar "debts for" locution likewise used in §§ 523(a)(4) and (a)(6), it has used language sensibly and consistently to accomplish that objective.

That consistency of usage and meaning within § 523(a) can be preserved by reading (a)(2) to except only compensatory damages. This Court, therefore, should reverse the decision of the lower court, and allow the petitioner to discharge these punitive damages in bankruptcy, as this reading of § 523(a)(2)(A) best harmonizes several related provisions of the Bankruptcy Code.

C. The Third Circuit's Interpretation Of Section 523(a)(2) Is Unnecessarily Disruptive Of The Fresh Start Policy

It has long been, and remains, a chief objective of our bankruptcy law to "enable [the debtor] to take a fresh start." *Traer v. Clews*, 115 U.S. at 541; *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. at 554-55 (primary purpose of the Bankruptcy Act is to release the debtor from the burden of his obligations so that he may be given a new economic start in life). *See also Grogan*, 498 U.S. at 286 (granting a fresh start is a "central purpose of the Code").

There is also a longstanding and inherent tension in our bankruptcy system between this policy of allowing a fresh start, and the advancement of particular policies of accountability and responsibility by denying discharge for certain categories of debt. *See* 11 U.S.C. § 523(a). These exceptions balance the rights of debtors and creditors by "exclud[ing] from the general policy of discharge certain categories of debts." *Grogan*, 498 U.S. at 287.[14] Evidently, Congress "concluded that the creditor's interest in recovering full payment of debts in these categories outweighed the debtor's interest in a complete fresh start." *Id.*; *see also Bruning v. United States*, 376 U.S. 358, 361 (1964) (noting that the discharge exceptions under § 17a "demonstrate[] congressional judgment that certain problems . . . override the value of giving the debtor a wholly fresh start"). Clearly, "Congress may prescribe any regulations concerning discharge in bankruptcy that are not so grossly unreasonable as to be incompatible with the fundamental law." *Hanover Nat'l Bank v. Moyses*, 186 U.S. at 192. And when it does so, it is the duty of the courts to enforce those policy judgments as made, and not to override them. *United States v. Sotelo*, 436 U.S. 268, 279 (1977).

Accordingly, it is well established that the various exceptions to discharge found in § 523(a) must be construed in accordance with their terms, if the policy balance intended by Congress is to be realized. *See Segal v. Rochelle*, 382 U.S. 375, 380 (1966) (construction of the Bankruptcy Act must be tempered by the

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[14] These categories did not enter the bankruptcy code contemporaneously. Instead, they have become part of our bankruptcy law over the past one hundred years. *See, e.g.*, 11 U.S.C. § 523(a)(2)(A) (originally enacted in a different form in the Bankruptcy Act of 1898); 11 U.S.C. § 523(a)(4) (originally enacted as part of the Bankruptcy Act of 1898); 11 U.S.C. § 523(a)(6) (originally enacted as part of the Bankruptcy Act of 1898); 11 U.S.C. § 523(a)(7) (originally enacted as part of the Bankruptcy Reform Act of 1978); 11 U.S.C. § 523(a)(9) (originally enacted as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984).

intent of Congress to "leave the bankrupt free after the date of his petition to accumulate new wealth in the future" and thus "make an unencumbered fresh start").

Far from vindicating this core purpose of bankruptcy policy, the decision below frustrates this crucial bankruptcy aim. Properly read, the interrelated provisions of § 523(a) render nondischargeable both debts that are compensatory in nature, "to the extent" they reflect amounts "obtained by" fraud-related conduct referenced in (a)(2), and, in certain particularly defined instances, other debts "for" fraud that are non-compensatory and punitive in nature.[15] This latter category of nondischargeable debts owed by the bankruptcy debtor not as compensation but rather as punishment, include those awarded "for" fraudulent conduct by a fiduciary (as defined in (a)(4)), "for" conduct that meets the "willful *and* malicious" standard (under (a)(6)), and those resulting from non-compensatory fines, penalties, or forfeitures, payable to the government (under (a)(7)).[16]

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[15] Congress disfavored non-discharge under §§ 523(a)(2), (a)(4), and (a)(6) by requiring creditors to whom such debts are owed to bring an action in the bankruptcy court. 11 U.S.C. § 523(c)(1).

[16] In addition to frustrating this specific balance embodied in the Bankruptcy Code, there is good reason to believe that the Third Circuit's overbroad reading of § 523(a)(2) is actually at odds with the objectives behind many punitive awards as well. Many courts have observed that punitive damages should not financially ruin the defendant. *Wynn Oil Co. v. Purolator Chem. Corp.*, 403 F. Supp. 226, 232 (M.D. Fla. 1974) ("the award of punitive damages should only hurt but not bankrupt a defendant") (reducing award from $4 million to $1 million); *Herman v. Hess Oil Virgin Islands Corp.*, 379 F. Supp. 1268, 1276-77 (D. V.I. 1974) (punitive award reduced to $1 million from $5 million which was excessive compared to company net worth of $3.5 million and net income of $1.75 million), *aff'd*, 524 F.2d 767 (3d Cir. 1975); *Holmes v. Hollingsworth*, 352 S.W.2d 96, 99-100 (Ark. 1961) (reducing punitives from $4,000 to $2,500 due to defendant's financial condition); *Thiry v. Armstrong World Indus.*, 661 P.2d 515, 518 (Okla. 1983) (the goal of punitive damages is "to punish and deter, not bankrupt and

Instead of following this clear directive of the statute, the court below has created an open-ended nondischarge provision for punitive damages assessed for any type of fraud.[17] It has done so not on the basis of any indication of congressional intent, and certainly not based on the statute's language, but rather primarily based on its own policy analysis and perception of how the statute will operate under the alternative interpretations. In particular, the court below noted:

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destroy"); *Arceneaux v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 767 F.2d 1498, 1503 (11th Cir. 1985) ("[P]unitive damages should not be so out of proportion to the defendant's net worth that it destroys him."); *Campus Sweater & Sportswear Co. v. M.B. Kahn Constr. Co.*, 515 F. Supp. 64, 106 (D.S.C. 1979) ("[I]t is well-known that the purpose of punitives is not to 'bankrupt' a defendant, but simply to deter him and other from similar conduct in the future."), *aff'd without op.*, 644 F.2d 877 (4th Cir. 1981). This concern is also reflected in rules permitting a defendant to demonstrate his penury to mitigate the amount of the award. *Adams v. Murakami*, 813 P.2d 1348, 1351-56 (Cal. 1991) (defendant must have opportunity to present evdience of financial condition to mitigate the amount of the award); *see generally* 1 L. Schluetter & K. Redden, *Punitive Damages* § 5.3(F) (2d ed. 1995). A decision to deny discharge of debts imposed as punishment is especially likely to have the unintended, long-term destructive effect that these cases reference, and that consequence is magnified the more broadly the denial of discharge is extended. Limiting the denial of discharge for punitive debts to particularly aggravated circumstances singled out by Congress, *e.g.*, § 523(a)(4) or § 523(a)(6), thus not only serves to advance the fresh start policy, but also the objective to deter but not destroy that underlies many punitive award sanctions.

[17] Because fraud for purposes of § 523(a)(2) encompasses falsehoods based on recklessness, as construed and applied by courts across the country, *see* note 5, *supra*, the range of conduct for which punitive sums are excepted from discharge is broad indeed, and far broader than the exceptions created by (a)(4) and (a)(6) which reach punitive amounts in the instances of fraud by a fiduciary and fraud that is willful and malicious in character.

> Furthermore, the amount of actual damages in consumer fraud cases, although significant to the plaintiffs, is often not large. Without including treble damages in the nondischargeable debt, victims of fraud will have even greater difficulty obtaining competent legal representation to pursue adversary actions in bankruptcy court and prevent fraudulent debtors from using the Bankruptcy Code to evade lawful state judgments.

Pet. App. 13a. Surely this type of legislative reasoning has no place in a judicial decision construing the unmistakeable language of § 523(a)(2)(A); it is all the more inappropriate due to its dubious factual basis and its inconsistency with Congress's own policy conclusions reached on a closely related issue.

First, this evaluation of "policy considerations" by the court below involves a gross and inaccurate generalization about the types of actions at issue under § 523(a)(2). The court rested its conclusion substantially on the premise that the "consumer fraud" cases in issue under (a)(2) involve creditor victims with small claims and limited means, who are likely to have great difficulty "obtaining competent legal representation" to pursue fraudulent debtors, once those debtors have declared bankruptcy. Pet. App. 13a. Thus, the court reasoned, these creditors need the added incentive and edge that a nondischargeable punitive award can provide. This perception, however, misunderstands fundamentally the nature of the cases predominantly confronted under § 523(a)(2). In the world of individual bankruptcies to which § 523(a) is limited, the balance of economic power is often not as the court seems to suppose. Individuals declaring bankruptcy will often be pursued by much larger entities seeking recovery for unpaid bills, who will often retain collection counsel as a regular part of their business.

Accordingly, if the Third Circuit's construction of the statute were upheld, it would clearly result in the nondischargeability of windfall amounts payable to major commercial creditors, at the expense of the opportunity for individual debtors to escape "the burden of hopeless insolvency" that has always been at the heart

of the bankruptcy process.[18] This could undermine in a major way the effectiveness of the fresh start policy, in order to protect the commercial interests of large enterprises seeking a right to pursue amounts much larger than what they have in fact lost.

Second, the incongruity of this result with Congressional intent is demonstrated by a legislative determination made in 1978, during the enactment of the Bankruptcy Code. At that time, there was an active and open debate about whether to eliminate the existing nondischarge language of (a)(2) relating to consumer debt obtained by the use of false financial statements.[19] While that debate was resolved by retaining the existing provisions, Congress took another action which indicated its concern for abuse not by debtors, as articulated by the Third Circuit, but rather by creditors. It created, in § 523(d), a new provision for award of

[18] Moreover, it is clear that the creditors' bar is well focused on the need to pursue this avenue of relief. *See* K. Coleman, *Bankruptcy for Bankers*, 114 Banking L. J. 731, 737 (1997) (discussing at length the decision below, and urging based upon it that "banks and other creditors should strongly argue against the dischargeability of punitive damage claims in those jurisdictions that have not yet decided the issue. The decisions of the Third and Eleventh [in *In re St. Laurent*, 991 F.2d 672 (11th Cir. 1993)] Circuits should provide great assistance to them in this regard.")

[19] In the early 1970s, at the direction of Congress, a comprehensive study of U.S. bankruptcy law occurred under the auspices of a specially-created Commission on the Bankruptcy Laws of the United States. The Commission's Report, H. Doc. No. 137, 93rd Cong., 1st Sess. (1973), which included a proposed new bankruptcy code, recommended the elimination of the nondischargeability of a consumer debt obtained by use of a false financial statement. *Id.* (Part I), at 176, (Part II), at 136 & 138-39 (discussing proposed § 4-506(a)(2)). As the Commission Report indicated, *id.* (Part I) at 176, and as Congress subsequently determined, H. Rep. No. 595 at 117, 130-31 *reprinted in* 1978 U.S.C.C.A.N. 6077, 6091-92; S. Rep. No. 989 at 6, *reprinted in* 1978 U.S.C.C.A.N. 5792, the fraud exception was subject to abuse by creditors.

attorneys' fees in disputes concerning consumer debts under § 523(a)(2), which allowed fees and costs to victorious debtors in such disputes about (a)(2) dischargeability, *but not to victorious creditors*.[20] *See Field v. Mans*, 116 S.Ct. 437, 447 & n.13 (1995). Congress thus showed its concern — running directly contrary to that expressed by the Third Circuit — to protect individual debtors against abusive creditors who it feared might be prone to press unreasonably for nondischarge findings on the basis of trumped up claims of fraud. Accordingly, the driving force behind the Third Circuit's opinion — the perceived need to provide adequate incentives to fraud creditors under § 523(a)(2) — was expressly rejected by Congress when, in 1978, it created the one-sided, debtor-only attorneys' fee award provision in § 523(d).

Interpretation of § 523(a)(2) to render nondischargeable only compensatory amounts "obtained by" fraud is therefore indicated not only by its plain language and by its relationship to the other provisions of § 523(a), but also by congressional policies identifiable in the Bankruptcy Code. Reading the provision in accordance with its terms honors the balance struck by Congress between the overriding policy of allowing debtors a fresh start

[20] Section 523(d), as amended, currently provides:

> If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. § 523(d). *See* S. Rep. No. 989 at 80, *reprinted in* 1978 U.S.C.C.A.N. 5866 (explaining reason for denying attorneys' fees to victorious creditors); H. Rep. No. 595 at 131, *reprinted in* 1978 U.S.C.C.A.N. 6092 (same).

and the concern to demand accountability for certain egregious forms of conduct.

CONCLUSION

For all of the reasons set forth above, the decision of the United States Court of Appeals for the Third Circuit holding nondischargeable under 11 U.S.C.§523(a)(2)(A) the punitive portion of the treble damage award entered under the New Jersey Consumer Fraud Act must be reversed.

Respectfully submitted,

HOWARD J. BASHMAN
JOHN FRANCIS GOUGH
MONTGOMERY, MCCRACKEN
WALKER & RHOADS, LLP
123 South Broad Street
Philadelphia, PA 19109
(215) 772-1500

DONALD B. AYER
(Counsel of Record)
JAMES E. ANKLAM
JONES, DAY, REAVIS &
POGUE
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3939

Counsel for Petitioner

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